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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 25, 2000

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: **Ex Parte Presentation**
CC Docket No. 96-98/Implementation of the Local Competition
Provisions in the Telecommunications Act of 1996
CC Docket No. 99-68 Inter-Carrier Compensation for
ISP-Bound Traffic

Dear Ms. Salas:

On September 22, 2000, Priscilla Hill Ardoin, David Hostetter and I met with Dorothy Attwood and Tamara Preiss of the Common Carrier Bureau to discuss the above referenced proceeding. The attached served as the basis of the discussion.

Respectfully Submitted,

A handwritten signature in cursive script, appearing to read "Gary L. Phillips".

Attachment

cc: D. Attwood
T. Preiss

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List A B C D E

THE RECIPROCAL COMPENSATION PROVISIONS OF THE ACT DO NOT APPLY TO ISP-BOUND TRAFFIC

I. THE COMMISSION WAS CORRECT WHEN IT HELD THAT § 251(b)(5) APPLIES ONLY TO LOCAL TELECOMMUNICATIONS TRAFFIC.

A. THE RATIONALE FOR THE HOLDING

- The Commission relied upon a call compensation analysis in the *Local Competition Order* in determining the applicability of reciprocal compensation. (¶ 1034)
- Specifically, the Commission found that when more than one carrier is involved in call completion (originating and “terminating” functions), the carrier that is paid for call completion is responsible for compensating the other carrier(s).
 - In the case of local traffic, the calling party is assumed to pay its LEC for call completion (both originating and terminating functions). The originating LEC thus must pay the terminating LEC reciprocal compensation.
 - In the case of interexchange traffic, the calling party pays its long distance carrier, not its LEC, for call completion (originating and terminating functions). Thus, reciprocal compensation is not required. Instead, the long distance carrier, which has been paid by the end user for the call, pays switched access charges to the originating and terminating carriers for the use of their networks in call completion.

B. ISP-BOUND TRAFFIC DOES NOT FIT THE LOCAL CALL MODEL BUT RATHER FITS SQUARELY WITHIN THE COMPENSATION MODEL FOR LONG-DISTANCE TRAFFIC.

- Although the FCC exempted ISPs from paying carrier access charges for the access services they use, the exemption simply changed the amount of money ESPs must pay for the access services they use.
- Specifically, instead of paying carrier access charges, ESPs were obligated to pay: (1) business line or other state tariffed charges; (2) the subscriber line charge; (3) special access surcharges for each private line channel they use.
- The FCC consistently has recognized that, notwithstanding the exemption, the ISP, not the originating end user, pays for ISP-bound traffic. For example:
 - In one of the original access charge orders, the FCC expressly noted that the local business line rate paid by ESPs covers the cost, not only of the ESP’s telephone line, but also the switching function used to deliver interstate traffic

to the ESP – the very function covered by reciprocal compensation. (97 FCC2d 682 ¶ 88)

- At the same time, the FCC held that ESPs also may be assessed special access surcharges and it characterized those charges as a “surrogate” for carrier access charges. (FCC
- ISPs use special access services to connect their premises to the Internet and accordingly are subject to special access surcharges.
- In its 1987 NPRM proposing to lift the ESP exemption, the FCC reiterated its understanding that ESPs pay for the access services they use, expressing concern that “the charges currently paid by enhanced service providers do not contribute sufficiently to the costs of the exchange access facilities they use[.]” (2 FCC Rcd. 4305, ¶ 7)
- Moreover, when, in the *Access Reform Proceeding* in 1997, ILECs argued that they were unable to recover their costs associated with ISP-bound traffic as a result of the access charge exemption, the FCC stated that if this were the case, they should raise the rates they charge ISPs. (12 FCC Rcd. at 16134)
- The D.C. Circuit also has recognized that ISPs – not the originating end users - pay for the access service they receive. In its order upholding the exemption it stated that “the access charges paid by ...ESPs may thus not fully reflect their relative use of exchange access.” (*NARUC v. FCC*, 737 F.2d at 1136)
- Because the LEC on the originating end of ISP-bound traffic is uncompensated when another LEC serves the ISP, ISP-bound traffic does not fit the local call model.
- Because end users pay subscriber fees to their Internet service provider, which, in turn, pays its LEC for the access services it uses, ISP-bound traffic falls squarely within the compensation model for long-distance traffic.

C. THAT THE CLEC SERVING THE ISP IS PAID FOR ISP-BOUND TRAFFIC REFLECTS NOT ONLY REGULATORY THEORY BUT REAL-WORLD ECONOMICS.

- CLECs who serve ISPs perform one function only for those ISPs: they deliver incoming traffic. Thus, it is impossible to view the revenues paid by the ISP as anything but payment for the receipt of traffic.
- In a very real sense, the access charge exemption is irrelevant to the CLECs’ ability to recover their costs for ISP-bound traffic. Because CLEC rates are deregulated, the CLECs decide – just as they do for ordinary voice traffic - what rate to charge their ISP customers for the access services provided to those customers. They have every ability to set a rate that covers their costs.

- CLECs are not constrained in their pricing by ILEC business line rates: ISPs do not typically use business lines for ISP-bound traffic. They use more sophisticated services, such as ISDN prime services.
 - Also, CLECs enjoy a number of cost savings over ILECs – which enables them to cover their costs with less revenue.
 - For example, ISPs may typically collocate their servers at CLEC switches– thereby saving loop costs.
 - CLECs also use scaled-down switches or SS7 gateways instead of switches.
 - CLECs do, in fact, recover their costs.
 - SBC study showed that revenues from ISDN prime services (using SBC tariffed rates) exceed by 30% the costs of delivering traffic to an ISP (using state-approved tandem switching rate as cost proxy).
 - While detailed data on CLEC costs and revenues is scarce (and CLECs steadfastly refuse to provide such data in state proceedings), recent prospectus by Pac-West revealed that its revenues from just its ISP customers during the 1st 6 months of 1999 nearly covered all of its operational costs for all of its services.
- D. SECTION 251(i) CONFIRMS THAT CONGRESS INTENDED THAT § 251(b)(5) APPLY TO LOCAL, NOT INTERSTATE TRAFFIC.
- Section 251(i) provides that “nothing in [section 251] shall be construed to limit or otherwise affect the Commission’s authority under section 201.” The application of section 251(b)(5) to ISP-bound traffic necessarily would limit or affect the Commission’s authority under section 201. It would strip the Commission of its plenary authority under that section and mandate a particular type of compensation regime.

II. ISP-BOUND TRAFFIC IS NOT LOCAL TRAFFIC

A. THE END-TO-END ANALYSIS IS CONTROLLING

1. THE END-TO-END ANALYSIS IS NOT JUST A JURISDICTIONAL TOOL, BUT AN ANALYTICAL CONSTRUCT USED TO DEFINE THE BOUNDARIES OF A COMMUNICATION FOR JURISDICTIONAL OR REGULATORY PURPOSES.
- The Commission has applied the end-to-end analysis every time it has been called upon to determine the end points of a communication, including in matters having nothing to do with jurisdiction.
 - *Teleconnect v. Bell Telephone Co.*: the Commission applied end-to-end analysis in rejecting arguments that an 800 call used to connect to an IXC switch was a separate communication for purposes of the access charge regime from the long-distance call placed from that switch.

Both the Bureau and the Commission expressly recognized that there is no basis for limiting end-to-end principles to jurisdictional determinations:

CCB: "Just as Commission regulation does not end with an intermediate switch, neither does the character of [a] call change at [an] intermediate switch."

FCC: "While Nevada Bell and Pacific Bell attempt to distinguish the so-called 'jurisdictional' nature of a call from its status for 'billing' purposes, they present no persuasive argument nor any authority to support their contention that this distinction has legal significance."

- *International Telecharge, Inc. v. SWBT et al.*: FCC held that an 800 call used to access an operator service center was, for access charge purposes, part of a single-end-to-end communication (11 FCC Rcd 10061).
- *Bill Correctors, Inc. v. Pacific Bell*, FCC applied end-to-end analysis in determining status of FX traffic under the access charge regime (10 FCC Rcd 2305).
- *AT&T Corp. Bell Atlantic-PA*: FCC applied end-to-end analysis in holding that "a call redirected by call forwarding does not terminate at the location dialed by the caller" and thus does not warrant the application of "intermediate" CCL charges (14 FCC Rcd 556).
- *Request by RCN Telecom Services and Bell Atlantic for Clarification*: FCC applied end-to-end analysis in holding that Bell Atlantic is not providing interLATA service when it hands off traffic to a CLEC across

LATA boundaries if the ultimate beginning and end points of the communication are in the same LATA (14 FCC Rcd 13861).

2. THE END-TO-END ANALYSIS APPLIES AS MUCH TO ISP-BOUND TRAFFIC AS TO TRADITIONAL LONG-DISTANCE VOICE TRAFFIC.

- End-to-end analysis is used to gauge the boundaries of all types of communications by wire and radio, not just traditional long-distance voice traffic:
 - *Idaho Microwave, Inc. v. FCC* (applying end-to-end analysis to television signals carried on microwave facilities) (352 F.2d 729)
 - *General Telephone Co. v. Calif.* (applying end-to-end analysis to cable television programming distributed over telephone company lines) (413 F.2d 390)
- End-to-end analysis applies as much to packet-switched communications as any other communications. As the Commission recognized, packet switched services are "pure transmission services" that "do[] no more than transport information of the user's choosing between or among user-specified points, without change in the form of content of the information as sent and received[.]" CC Docket 98-147, FCC 98-188, 8/7/98, ¶ 35.
- CLECs effectively concede that the end-to-end analysis applies to Internet communications because they concede that ISP-bound traffic is jurisdictionally interstate under that analysis.

3. CLECS HAVE NOT IDENTIFIED A SINGLE INSTANCE IN WHICH ANY OTHER CONSTRUCT HAS BEEN USED TO IDENTIFY THE BOUNDARIES OF A COMMUNICATION.

B. THE FACT THAT ISPs ARE CLASSIFIED AS INFORMATION SERVICE PROVIDERS DOES NOT MEAN THAT ISP-BOUND TRAFFIC TERMINATES AT THE ISP SERVER.

- Since 1983, the FCC has recognized that LECs provide access service when they deliver traffic to an ESP. Access service is defined in FCC rules as "services and facilities provided for the origination and termination of any interstate or foreign telecommunication." (47 CFR § 69.2) Thus, for 17 years, the FCC has recognized that telecommunications does not terminate upon delivery of traffic to an ESP.
- This makes good sense: an information service is nothing more than a telecom service with added functionality. Thus a telecom service underlies every information service.

- The fact that under FCC regulations, ISPs are generally treated as users, not providers, of telecom services does not mean, as the court suggested, that ISPs are no different from other communications-intensive businesses, such as pizza delivery firms, travel agents, etc. Unlike these other businesses, ISPs do not merely use telecommunications to conduct their businesses; they forward subscriber-initiated communications to destinations on the Internet.
- In this respect, the Court's suggestion that ISPs originate communications on behalf of their subscribers was wrong.
 - *See e.g., Advanced Services Remand Order* at ¶ 35: "the service provided by the local exchange carrier to the ISP is ordinarily exchange access service because it enables the ISP to transport the communication initiated by the end-user subscriber located in one exchange to its ultimate destination in another exchange."
- The fact that telecom services and information services are deemed mutually exclusive regulatory categories is a red herring.
 - It means only that a provider of an information service is not considered a provider of a telecommunications service by virtue of the telecommunications underlying its information service. (*Universal Service Report*, ¶ 57) It does not mean that the telecommunications services underlying the information service does not exist at all.
 - In fact, the FCC requires the provider of this telecom service to contribute to universal service support mechanisms. It even left open the possibility that the ISP itself might be required to contribute to universal service support to the extent it provides its own backbone services.
 - In *BellSouth MemoryCall Order*, FCC squarely held that, for purposes of determining the boundaries of a communication, a telecom service that connects to an information service is no different from an ordinary phone call:

"When a caller is connected to BellSouth's voice mail service ... there is a continuous path of communications across state lines between the caller and the voice mail service, just as there is when a traditional out-of-state long distance voice telephone call is forwarded by the local switch to another location in the state and answered by a person, a message service bureau or customer premises answering device." (7 FCC Rcd 1619, ¶ 9 (emphasis added))

C. ISP-BOUND TRAFFIC DOES NOT TERMINATE AT THE ISP SERVER UNDER SECTION 51.701(d) OF THE COMMISSION'S RULES.

- While § 51.701(d) describes the termination "function" in order to distinguish that "function" from the "transport" function (*see Local Competition Order* at ¶ 1040), "termination" is not defined solely with respect to functionality, as CLECs claim. Rather, under the express terms of the rule, the termination functionality must be provided in connection with "local telecommunications traffic" that is delivered to the "called party."
 - In the *Local Competition Order*, the Commission rejected a purely functional definition of "termination," noting that under such a definition, access traffic, as well as local traffic, would be subject to reciprocal compensation. (¶ 1033)
- ISP-bound traffic is not "local telecommunications traffic."
 - CLEC claim that the definition of "termination" should be bootstrapped into the definition of "local telecommunications traffic" – such that "local telecommunications traffic" is simply traffic for which the "terminating" and "originating" functionalities are performed within the same local calling area – goes too far: if that were true, an access code call delivered to an IXC within the end user's local calling area would likewise be subject to reciprocal compensation, in express violation of the Commission's stated policy.
- The ISP is not the "called party."
 - While consumers use an ISP as a conduit through which to send and receive transmissions over the Internet, their intent is not to communicate with the ISP, but to send and receive information to and from the Internet. *E.g.*, a user that sends an e-mail or that participates in on-line chat is communicating with the person to whom the e-mail is addressed or with those in the "chat room", not her ISP. Likewise, a user that sends or retrieves information to or from a web site is communicating with the proprietor of that site, not her ISP.
 - ISP-bound traffic could not be interstate if the ISP were the called party. Rather, there would be two separate calls, the first of which would be jurisdictionally intrastate.
 - In *Teleconnect v. Bell Telephone Co.*, the FCC specifically referred to the person at the ultimate end point of the communication – not the intermediate switching point – as the "called party."
- AT&T agrees that § 51.701(d) "in no way purports to define what traffic is 'local' and what traffic is 'non-local.'"

D. **THE COMMISSION HAS NEVER RETREATED FROM THE VIEW THAT
ISP-BOUND TRAFFIC IS ACCESS TRAFFIC.**

- In stating in the *Access Reform Order* "it is not clear that ISPs use the public switched network in a manner analogous to IXC's," the Commission in no way implied that ISPs do not, in fact, use access services. Rather, at most the FCC was suggesting that ISPs *may* use the network in ways that warrant a different kind of access *pricing* structure than is used for long-distance services.
 - In fact, that is exactly what the FCC said: "The access charge system was designed for basic voice telephony provided over a circuit-switched network, and even when stripped of its current inefficiencies it may not be the most appropriate pricing structure for Internet access and other information services. (12 FCC Rcd at 16134)

E. **THE STATUS OF ISP-BOUND TRAFFIC AS EXCHANGE ACCESS OR
TELEPHONE EXCHANGE SERVICE HAS NO BEARING ON WHETHER IT
IS SUBJECT TO RECIPROCAL COMPENSATION.**

- Neither §251(b)(5), nor the Commission's reciprocal compensation rules apply by their terms to "telephone exchange service. Rather, they apply to "local telecommunications traffic" – a term that is defined differently from the term "telephone exchange service." Thus, it does not matter, for reciprocal compensation purposes whether ISP-bound traffic fits the statutory definition of telephone exchange service.
- In any event, the Commission has now ruled that ISP-bound traffic is exchange access, and that ruling is entitled to *Chevron* deference.

III. **BECAUSE ISP-BOUND TRAFFIC IS NOT SUBJECT TO § 251(b)(5), IT
CAN AND SHOULD BE SUBJECT TO BILL AND KEEP.**

- Because it is predominantly interstate, inseverable traffic, ISP-bound traffic is subject to the Commission's authority under section 201, not section 251(b)(5), and under section 201, the Commission may prescribe any compensation methodology that is just and reasonable, including bill and keep.
- A bill and keep methodology would be in the public interest.
 - Reciprocal compensation for ISP-bound traffic forces carriers who are uncompensated for that traffic to provide double recovery to the carrier that is compensated.

- Even if the Commission were not convinced that the CLEC was fully compensated by its ISP customer, there is no reason why the revenues reasonably available from the ISP ought to be wholly disregarded.
- Reciprocal compensation for ISP-bound traffic also is antithetical to every key goal articulated by the FCC in its NPRM.
 - It discourages competition in the consumer market.
 - It discourages CLECs from deploying advanced services.
 - It distorts investment decisions
 - It institutionalizes irrational pricing.

IV. A TRANSITION TO BILL AND KEEP IS UNNECESSARY, BUT THE COMMISSION HAS LEGAL AUTHORITY TO ESTABLISH A REASONABLE TRANSITION.

A. THE CLECS HAVE BENEFITTED FROM THIS ARBITRAGE FOR LONG ENOUGH AND HAVE BEEN ON NOTICE FOR SOME TIME THAT ANY FURTHER TRANSITION PERIOD IS UNNECESSARY

- The CLECs have been on notice since early 1997 that their claims for reciprocal compensation for ISP-bound traffic were disputed. For 2 years, CLECs and ILEC debated before the Commission the issue of whether ISP-bound traffic terminates at the ISP server. The ILECs relied on 50 years of precedent to support their arguments. The CLECs could not responsibly have assumed that this revenue stream would continue.
- In February 1999, the Commission rejected the legal theory upon which the CLECs based their claimed right to receive reciprocal compensation.
- Wall Street recognized more than two years ago that reciprocal compensation for ISP-bound traffic was untenable. CLEC valuations assume reciprocal compensation revenues will decline steeply, if not disappear altogether.

B. IF THE COMMISSION NEVERTHELESS DEEMS A TRANSITION PERIOD NECESSARY, IT MAY ESTABLISH A REASONABLE TRANSITION.

- There is ample precedent for transitions necessary to minimize market dislocation
 - *E.g.*, the transition from the equal charge per unit of traffic rule.
 - *Local Competition Order* restrictions on UNEs pending full implementation of access and universal service reform.
- Any transition must take into account that Internet traffic doubles every 100 days.

V. THE COMMISSION COULD CONDITION THE AVAILABILITY OF BILL AND KEEP FOR ISP TRAFFIC ON THE AVAILABILITY OF BILL AND KEEP FOR ALL LOCAL TRAFFIC (INCLUDING WIRELESS).

- There is a legal distinction between a condition and a requirement. One is voluntary; one is not. Indeed, the Commission has a long history of establishing conditions that could not have been independently required (*e.g.*, UNE and resale discounts that were condition for SBC/Ameritech merger).
- This proposal is responsive to CLEC arguments (which are, in any event lacking in merit) that ISP traffic is like local traffic; the adoption of bill and keep for ISP traffic would lead to excessive interconnection rates for local traffic; and that it would be burdensome to distinguish ISP traffic from local traffic for reciprocal compensation purposes.

VI. IN THE ALTERNATIVE, THE COMMISSION COULD ESTABLISH A PRESUMPTION THAT TRAFFIC IN EXCESS OF A 2:1 RATIO IS NON-COMPENSABLE.

- This proposal is consistent with FCC rules because presumption would be rebuttable to extent a LEC could demonstrate that its ratio of outbound/inbound local traffic vis-à-vis another LEC exceeded 2:1.
- The proposal permits some recovery for ISP traffic but presents excessive gaming of the reciprocal compensation rules.
- The proposal encourages CLECs to sign up customers that originate traffic because for every additional minute of traffic they originate they can collect compensation on 2 minutes of ISP traffic.

VII. THE COMMISSION CAN AND SHOULD CLARIFY THAT CARRIERS MAY NOT MFN INTO THE RECIPROCAL COMPENSATION PROVISIONS OF GRANDFATHERED AGREEMENTS.

A. IF CARRIERS ARE PERMITTED TO ADOPT THE RECIPROCAL COMPENSATION TERMS OF OTHER INTERCONNECTION AGREEMENTS, THE COMMISSION'S NEW REGIME WILL BE EFFECTIVELY DEFERRED FOR 3 YEARS.

- Particularly given the explosive growth of Internet traffic, that is an untenable situation, particularly without a mechanism by which ILECs can recover their costs.

B. CARRIERS HAVE NO RIGHT TO ADOPT RECIPROCAL COMPENSATION TERMS OF GRANDFATHERED AGREEMENTS

- Section 252(i) does not authorize the adoption of reciprocal compensation provisions in an interconnection agreement.
 - Section 252(i) requires ILECs to make available “any interconnection, service, or network element” that they provide to a CLEC.
 - The transport and termination of traffic by a CLEC is not an interconnection service or network element provided by an ILEC.
 - The application of § 252(i) to reciprocal compensation terms would be inconsistent with the pricing provisions of § 252d)(2) – which entitle carriers to recover their own costs – not the costs of some other carrier.
- Even if the Commission concludes that the reciprocal compensation provisions of an interconnection agreement may be adopted, the adoption of a grandfathered agreement would be inconsistent with § 51.809(c) of the Commission’s rules.
- § 51.809(c) of the Commission’s rules requires ILECs to allow adoption of interconnection provisions for a “reasonable period of time after the approved agreement is available for public inspection.”
 - What is “reasonable” depends upon the circumstances.
 - The reasonable period of time for making available reciprocal compensation terms that were negotiated or arbitrated prior to the FCC’s rules expires once the FCC finally adopts a federal regime for this traffic
- The FCC also may – but need not – rely on its forbearance authority.